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Success, Law and ESG

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University of Oxford and ECGI

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Abstract

The notion of corporate success lies at the heart of directors' duties in many corporate laws. Freedom of incorporation conferred considerable discretion on companies to determine the nature of their success and create financial value for their investors, subject to conforming with laws and regulation. However, this increasingly came into conflict with the interests of other stakeholders, in particular employees, supply chains, the environment and societies, and addressing the problem through specific regulatory rules proved inadequate to the task. This raises questions about the nature of the financial incentives that drive and resource corporate activities, namely profits, and the need to align these with the role of business in solving not creating problems for others. In the absence of such an alignment then markets fail, and competition can intensify rather diminish the failures. There are three aspects to addressing the problem. The first is the use of corporate law to require companies to consider the interests of stakeholders other than their shareholders. This is already a feature of many corporate laws. The second is corporate governance codes that promote corporate purposes of profiting from solving not causing problems for others. This too is already a feature of some countries' corporate governance arrangements. The third is the adoption of international standards and firm specific measures of performance that promote accounting and reporting on corporate social and environmental benefits and detriments. These are in the process of being established but need to be more closely related to accounting for specific firm measures of performance that ensure profits derive from solving not creating problems for others.

Keywords: Success, Profit, Corporate Law, Purpose, Governance, Regulation, Standards, Reporting

JEL Classifications: K2, L21, M14, M21, M4

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Success, Law and ESG[1]

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1 August 2024

Abstract

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This raises questions about the nature of the financial incentives that drive and resource corporate activities, namely profits, and the need to align these with the role of business in solving not creating problems for others. In the absence of such an alignment then markets fail, and competition can intensify rather diminish the failures.

There are three aspects to addressing the problem. The first is the use of corporate law to require companies to consider the interests of stakeholders other than their shareholders. This is already a feature of many corporate laws. The second is corporate governance codes that promote corporate purposes of profiting from solving not causing problems for others. This too is already a feature of some countries' corporate governance arrangements.

The third is the adoption of international standards and firm specific measures of performance that promote accounting and reporting on corporate social and environmental benefits and detriments. These are in the process of being established but need to be more closely related to accounting for specific firm measures of performance that ensure profits derive from solving not creating problems for others.

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[1] This article was written for the forthcoming book: *The Ethics of ESG: Critically Assessing the Environmental, Social and Governance Movement*, edited by Valentina Gentile, Eric Orts, Andreas Rasche and Alan Strudler, Cambridge: Cambridge University Press. The issues discussed in this article are described in greater detail in my book *Capitalism and Crises: How to Fix Them,* Oxford; Oxford University Press, 2024.

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“Formula for success: rise early, work hard, strike oil.”
J. Paul Getty (1892-1976)

What is Success?

“Success” and “interest” of the company lie at the heart of virtually every corporate law in the world. Directors of companies have a duty to promote the “success of the company”. But what is success and how does success relate to the theory and practice of ESG?

Success comes from the Latin *succedere/ successus* to come after, advance. It has a similar meaning to the word profit, which comes from the Latin *proficere/ profectus*, to progress, advance. In both cases the notion of success is in terms of advancement and progress. It is not therefore surprising that there is a strong association of success with profit in a corporate context.

The law frequently defines success in relation to the members or shareholders of a corporation and attributes it to profit or financial value creation for shareholders (Bainbridge (2023), Dodd (1932), Friedman (1970), Rock (2020 and 2021)). It is sometimes qualified by the term “long-term” value creation to contrast it with short-term profit, or by “sustainable” value creation to distinguish it from value creation that cannot be sustained or breaches environmental and planetary boundaries (Financial Markets Law Committee (2024), Keay (2008), Orts (2013), Paine (2023)).

Some people believe that the success of a company should relate to a broader class of stakeholders than just shareholders, for example customers, employees, suppliers, and communities. Others think that companies should consider the interests of stakeholders only to the extent that they contribute to or not detract from those of shareholders by enhancing financial value or not exposing them to greater financial risk.

For many, the J. Paul Getty quote above captures the essence of corporate success – a combination of character, conduct and consequence. Strength of character, commitment to purpose, and good fortune are the source and reward of success. But to others they are the cause of failure because they are only the initial stages in a process of producing personal prosperity that all too frequently comes at the expense of the interest of others and to the detriment of communal and natural world flourishing.

Whose Success?

The genius of freedom of incorporation in the 19th century was to liberate the corporation from the shackles of government. Instead of being chartered by government or parliament to perform certain functions, anyone could establish a business for whatever purpose they thought commercially viable, with protection of limited liability if it proved unviable.

Previously, any purpose which was not legally sanctioned by public charter was deemed illegal. With freedom of incorporation, this was turned on its head so that anything which was not in violation of private or public law was regarded as legal. No longer was it the higher authority of the state that determined what was legally permissible but instead competition in the market that established what was commercially viable.

Freedom to incorporate released an explosion of entrepreneurial activity and creativity that powered economic growth and development for the subsequent two hundred years. It was the source of economic prosperity, the growth of nations around the world, and the alleviation of much poverty. But over the last fifty years, we have become acutely aware of the increasing collateral damage it is causing, straining the world's environmental and social capacities to their limits.

At the heart of this dichotomy is that, in permitting founders and owners to establish the purposes of their businesses, freedom of incorporation made them the judges of their own success. Founders and owners became the markers of their own exam sheets, and anything they and their fellow shareholders categorized as success was treated as such, provided it was not specifically unlawful or in breach of regulation. If shareholders and other investors determined success to be profit or financial value creation then so be it, and it was by this criterion that the performance of a firm should be judged, so long as the firm remained solvent and within the boundaries set by private and public law.

This notion of success derives from a property view of the firm (Berle and Means (1932), Demsetz (1983)). According to this, owners have "sole and despotic dominion" in determining the use and management of the asset of a firm, provided they operate within the laws of the land (Blackstone (1765)). It may be in the interest of shareholders and other investors to take account of the wellbeing of others in promoting the success, earnings, and reputation of their firms, but that is for them to judge and ensure it is reflected in the conduct of their firms. Neither shareholders nor their agents, their directors, can be held to account for what others may deem to be inappropriate, provided it is not specifically illegal.

The Failure of Success

Outside the corporation, societies have created a plethora of instruments which stand between self-determination of individual purpose and the law in influencing human conduct. These include ethical and moral principles, communal and societal norms, customs and religion, and principles and values. The nature and influence of these considerations varies across nations, continents, and time, but in the normal course of our lives we do not in general adopt an approach of asserting that anything which is legal is acceptable.

These considerations are also relevant for businesses in so far as they are run by people with a concern for humanity. But it is unlikely that human norms and principles are sufficient on their own to restrain corporate conduct. There are several reasons for this. The first is that the influence of business on society and the environment is in general far greater than that of individuals.

Second, business must fight to survive, often in highly competitive markets. A principled approach to business is only feasible if competitors abide by it, otherwise the lowest common denominator of conduct prevails and infects all market participants to the point of driving the more principled out of the market altogether.

Third, and perhaps most significantly, those working in corporations frequently feel unable to express their own concerns about humanity because corporate profits trump individual morals. This is particularly the case where threats of shareholder resolutions, hostile takeovers or hedge fund activists hang like a sword of Damocles over the heads of company directors.

Adam Smith on Success

The failures of success derive from the origins of capitalism and the modern corporation. Consider three famous quotations of Adam Smith. The first is his assertion of the self-interest of business: “It is not from the benevolence of the butcher, the brewer or the baker that we expect our dinner, but from their regard to their own interest. We address ourselves not to their humanity but to their self-love, and we never talk to them of our own necessities but of their advantages” (Adam Smith (1776), Book 1, Chapter 2).

The second is how that self-interest is converted into societal interest. “He intends only his own gain, and he is, in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention” (Adam Smith (1776), Book 4, Chapter 3). The invisible hand of the market steers self-interest in the direction of societal benefits.

These two quotations both come from *The Wealth of Nations*. It is often felt hard to reconcile them with the sentiments that Adam Smith expressed in *The Theory of Moral Sentiments* and especially the presence in our consciousness of an impartial spectator. “We conceive ourselves as acting in the presence of …. an impartial spectator who considers our conduct with the same indifference with which we regard that of other people” (first introduced into 1762 edition of The Theory of Moral Sentiments - see Camp (2020)).

The moderating influence of the impartial spectator in *The Theory of Moral Sentiments* appears to have vanished by the time we get to *The Wealth of Nations* and been replaced by the invisible hand of the market. However, that would not be a correct interpretation because it ignores the prominent role for justice in *The Wealth of Nations*. “To hurt in any degree the interest of any one order of citizens for no other purpose but to promote that of some other, is evidently contrary to that justice and equality of treatment which the sovereign owes to all the different orders of his subjects” (Adam Smith (1776), Book 4, Chapter 8). Justice and fairness require that one party not be harmed for the benefit of another.

The importance of this relates to the central feature of a market in a well-functioning economy. “All systems either of preference or of restraint, therefore, being thus completely taken away, the obvious and simple system of natural liberty establishes itself of its own accord. Every man, as long as he does not violate the laws of justice, is left perfectly free to pursue his own interest in his own way, and to bring both his industry and capital into competition with those of any other man, or order of men (Adam Smith (1776), Book 4, Chapter 9).”

In other words, the avoidance of detriment being inflicted on one party for the benefit of another allows all parties to compete on equal terms with each other within the confines of the law. Without that, competition and the operation of market fail in promoting social wellbeing, and, on the contrary, can result in runs to the bottom rather than the top, by which a Gresham Law of bad firms driving out the good prevails.

Critical to this is recognition of the distinction that Smith draws between justice in the prevention of harm and the promotion of benefit. Its proper role is in relation to the former not the latter, because in relation to the latter it can be an infringement not an enhancement of individual freedom and choice. The role of private law of torts and contracts, and public law and regulation is to prevent harms and thereby to create a fair and level playing field.

Were this the end of the matter, we would stop here and say that there is no further role for the law, accounting or reporting to improve on the functioning of markets. The success of the company would be to follow the Milton Friedman (1970) doctrine of promoting the profitability of the company while remaining within the rules of the game and the law. But that is not the end of the matter because the impartial spectator has more to say than that.

A Successful Resolution

The impartial spectator brings an external perspective to individual self-interest in gain. Drawing on Smith's insights about the distinction between positive benefits and negative detriments in the context of justice, then reconciliation of corporate detriments with benefits requires no more than that corporate success excludes profit which derives from harm.

Profit should not come from harm. Companies should incur the costs of rectifying, remedying, or mitigating the harm they inflict on others, and they should make adequate provision for those costs arising in the future. In the absence of such a limitation, then corporate success risks being tainted by failure – the failure of benefiting some at the expense of others and profiting from wealth transfer rather than wealth creation. Profit as a result becomes a misstatement of its original Latin conception: *proficere* and *profectus*, to advance and progress.

Without a limitation on profiting without harm, profit is associated not just with advancement and progress but also with self-enrichment at cost to others, equivalent to unjust enrichment in an equitable sense of the illegitimate accumulation of property. The law prevents this by rendering illegal harms that are in violation of private law, public law and regulation.

This has implications for both the governance and stewardship of companies by their boards of directors and investors. It places a duty of care on directors to ensure that their companies have systems and processes in place to avoid detriments being imposed on other parties, and on controlling shareholders to establish that the benefits they derive from the success of their firms do not come at the expense of others.

Several recent proposals have advocated going beyond this by extending the parties to whom the firm should be accountable to stakeholders other than shareholders (see Fisch and Solomon (2021), Paine (2023), Schoenmaker, Schramade and Winter (2023)). However, this comes at risk of diluting the remarkable contribution business has made to human flourishing and wellbeing by requiring it to promote the interests of multiple parties. Instead, the duty of directors should remain solely to the success of the company for the benefit of its shareholders, provided success comes without detriment to others. It is then for the firm to determine whom it intends to help, in what form, when and how, in a commercially viable and profitable way without harming others.

This does not exclude the possibility of firms sacrificing profits for the benefit of other parties if that is felt to be either in the long-term financial interests of shareholders or the broader interests of shareholders in their welfare as well as their wealth (see Hart and Zingales (2017 and 2022)). Impact investors derive benefits from promoting environmentally and socially beneficial activities and are willing to forgo financial gains in the process. Likewise, philanthropic foundations that own companies, as in the enterprise foundations prevalent in Denmark (see Thomsen and Kavadis (2022)), have an interest in promoting their charitable objectives. But for the main body of shareholders who retain a sole interest in financial value creation, the pursuit of broader objectives requires the support of governments, public, social, not-for-profit, and philanthropic organizations to make them commercially viable.

The Case for Corporate Law

Underpinning this notion of corporate success and profit is corporate purpose. Corporate purpose is the reason why a business is created, why it exists and its reason for being. It is therefore very fundamental. Mounting concerns about the Friedman doctrine - that the sole social responsibility of business is to increase profits so long as it stays within the rules of the game - have prompted a plethora of alternative notions of corporate purpose, as advocated for example by the Business Roundtable (2019).

These typically incorporate stakeholder as well as shareholder interests in the objectives of a firm. However, they are subject to widespread criticism and scepticism that they are little more than corporate promotion, marketing and social responsibility campaigns (see Bebchuk and Tallarita (2020 and 2023)). They have thereby become embroiled in claims of greenwashing and woke capitalism which have engulfed ESG. Instead, they should be regarded as the opposite of promotion and voluntary philanthropy and recognized as the determinants of the problem-solving activities that are core to the strategy of a business.

The reason why a business is created and exists is to solve problems that you and I face as individuals, communities and the natural world, but they must do this in a particular way – a form that is commercially viable, profitable and financial value creating. Corporate purpose respects the significance of profit and financial value creation to business and reflects the fact that they derive from solving not creating problems for others. The purpose of a business is therefore to "produce profitable solutions for the problems of people and planet, not profiting from producing problems for either" (British Academy (2021) and Mayer (2024a)). An important corollary of this is that profit derives from solving not creating problems for others.

This notion of the purpose of a corporation should be the basis on which its success is judged in private and public law cases. It establishes whether breaches of contract, tort, public law or regulation derive from the pursuit of self- rather than other regarding interests. But there is more to it than that. It determines how businesses and those within them behave, and how their culture and trustworthiness uphold relations based on trust.

The case for incorporating a profit without harm requirement in corporate law instead of just a voluntary code or practice of companies is that there is a public as well as private good element in the functioning of competition and markets, and in the trustworthiness of business in general. By profiting at the expense of others, businesses damage not only their own reputations but those of business and markets at large.

Specific regulations of business do not capture the generic nature of its trustworthiness. This is reflected in the negative effect that profiting with harm has on the functioning of markets and the requirement for a level playing field to permit companies to roam freely in the competitive sphere. It is a public good in a non-market as well as a market sense in so far as confidence in business to promote public and private benefits without harm is a necessary requirement to avoid business being tainted with the brush of exploitation and expropriation.

A Hippocratic Oath of "do no harm" cannot apply to business because companies do harm all the time. They are routinely required to decide about undertaking production in one location to the detriment of communities and employees in another, or about raising wages to employees at the expense of prices charged to customers, or about eliminating plastic packaging by substituting less durable recyclable alternatives. The business equivalent of the Hippocratic Oath in medicine is "profit without harm" – incur the costs of avoiding, compensating or mitigating the detriments that a company inflicts on others.

Corporate law should therefore clarify that the success of a corporation excludes profit from harm. Companies are free to roam within the sphere of purposes of profiting from solving not creating problems for others, but they are expected to avoid straying outside this by incurring the costs of preventing harm or rectifying and remedying it where it occurs. If they do stray beyond the sphere of profiting from problem solving not creating purposes, then they should be subject to consequential private and public litigation and regulation. This is the only condition that needs to be imposed, because if companies cannot profit from harm, then they must profit from conferring benefits on at least some others.

In an exchange of articles with Paul Davies (Davies (2024) and Mayer (2024b)) about my earlier book, *Prosperity: Better Business Makes the Greater Good* (Mayer (2018)), I clarified my belief that the law should not seek to prescribe the positive problem-solving activities of companies but, on the contrary, encourage many flowers to bloom by enabling companies to commit to their problem-solving purposes. Without that ability to commit, problem-solving corporate statements risk being cheap talk, as Bechuk and Tallarita described of the BRT restatement of corporate purpose and *Prosperity* illustrated of earlier corporate statements.

In the absence of credible means to commit, instead of, as is often suggested, shareholder and stakeholder interests converging over the long-term, and time encouraging companies to reveal and heal, it allows them to conceal and steal. That may be reflected in, for example, long-term transitions to net zero that permit companies to backload and defer any serious commitment to carbon neutrality and net zero.

What *Prosperity* did not consider is the focus of this article and my most recent book (Mayer (2024a)), namely the negative aspect of problem creation rather than problem-solving and the level-playing field precondition required for competition to flourish, namely that companies should profit without harm.

The notion of the "interest" of the company, mentioned at the beginning of this article is used in many jurisdictions in place of the term "success". It comes closer to capturing the notion of profiting without harm. Interest comes from the Latin *interesse* –"to be between" – "to be of concern or affected by". In other words, it relates to those affected by and vulnerable to the activities of the company. It therefore incorporates a broader notion of stakeholder concerns about vulnerability to the impacts of companies beyond those of shareholders. The role of the director in this regard is that of a custodian, guardian or protector of the interests of those on whom the firm impacts.

Indeed, most people would be appalled to think that corporate success could derive from anything other than helping not harming those on whom the firm impacts and depends. Paul Getty's notion of success is now recognized to be the commencement not completion of a process. Striking oil starts a chain of actions from extraction to transportation, processing, refining, distribution, combustion, and application for which those at the start of the chain can no longer simply wring their hands and exclaim "not my problem".

Getty's definition reflects an era in which corporate success might legitimately have been self-referential because its environmental and social consequences were less significant or well understood than they are today. Those days have passed and there are few corporate directors or owners who can now be deemed to be fulfilling their duties if they do not recognize the wider significance of their businesses for the systems within which they operate.

It is not just Paul Getty's good fortune of striking oil that is the ultimate determinant of success but also, as Ralph Waldo Emerson's poem "What is Success?" (Emerson (1912)) suggests, the good done by leaving "the world a bit better whether by a healthy child, a garden patch or a redeemed social condition". "This", as Emerson said, "is to have succeeded."

The Example of the UK Companies Act

The UK Companies Act 2006 illustrates the potential and limitations of corporate law. S.172 of the Act states that: "A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to the likely consequences of any decision in the long term", and the interests of its employees, suppliers, customers, community, environment, reputation and balance of interests of its members.

The last part of having regard to the long-term and the interests of other stakeholders is described as "Enlightened Shareholder Value". It clarifies the matters to which directors should at least give consideration, but not necessarily act upon, in promoting the success of the company. It therefore provides guidance on, but does not fetter, the discretion of the board in exercising their business judgment.

This limited guidance retains clarity, certainty and predictability in administration of the law (Vos (2018)). Judges are not businesspeople. They are not equipped to, nor should they make business judgments. Their role is to ensure that directors act within their authority and abide by the law, not opine on the merits of decisions made.

Correspondingly, businesspeople are not politicians. They have neither the capability nor the authority to make political judgments. They should stick to their knitting of promoting the success of their business not making social or environmental judgments. It is the role of government to determine the laws and regulations that are the basis of judges' judgments and directors' decisions.

The UK Companies Act does not contravene these principles. It retains the sole focus of directors on promoting the success of the company for the benefit of its shareholders. It clarifies the issues in relation to society and the environment that directors should consider, and it leaves it to governments and regulators to determine where directors are required to act on their considerations.

In a discussion of the *Sequana SA* insolvency case (BTI 2014 LLC v. Sequana SA (2022) 3 WLR 709)), in which the UK Supreme Court concluded that directors owed a duty to creditors when "the company is insolvent or bordering on insolvency" (Arden (2024), para. 49), the former Justice of the Supreme Court of the UK, Lady Mary Arden considers its implications for director duties to parties other than their shareholders more generally. She concludes that legislation, equivalent to specific reference to creditors in s.172 (3) of the UK Companies Act 2006, would be required for a corresponding extension of duties to other stakeholders (Arden (2024), para. 73).

A recent proposed amendment to the New Zealand Companies Act demonstrates how principles of clarity, certainty and predictability in the administration of the law can be transgressed. The New Zealand Companies Act 1993 states that "a director of a company, when exercising powers or performing duties, must act in good faith and in what the director believes to be the best interests of the company". There is nothing unusual about this. However, the 2023 Amendment Act states that: "To avoid doubt, in considering the best interests of a company or holding company for the purposes of this section, a director may consider matters other than the maximisation of profit (for example, environmental, social, and governance matters)."

In other words, the best interests of a company may include ESG considerations or a purpose other than financial considerations. Far from dispelling doubt, this may create it. The amendment is not the same as the UK Companies Act, which subsumes ESG considerations within the promotion of the success of the company for the benefit of its members. The concern that the New Zealand amendment raises is precisely one of diminished clarity, certainty and predictability about corporate purpose, how it is measured and to whom the company is accountable for its implementation. And it fails to address the fundamental issue considered in this article of the potential for the pursuit of profit to come at the expense of environmental and social matters. It does not therefore create a level playing field, or restore trust in business, but instead risks doing the opposite.

To go beyond Enlightened Shareholder Value in a UK Company Law context without resorting to specific regulations, one should turn to standard setters and regulators of corporate governance, auditing and reporting. Principles B and C of the 2018 UK Corporate Governance Code established by the Financial Reporting Council (FRC) state that:
"The board should establish the company's purpose, values and strategy, and satisfy itself that these and its culture are aligned. All directors must act with integrity, lead by example and promote the desired culture" and

"The board should ensure that the necessary resources are in place for the company to meet its objectives and measure performance against them. The board should also establish a framework of prudent and effective controls, which enable risk to be assessed and managed." The revised Danish Corporate Governance Code has many similar features to the UK Code (Danish Committee on Corporate Governance (2020)).

It is therefore to the FRC (or its strengthened successor body – The Audit, Reporting and Governance Authority (ARGA) (Mountfield Chambers (2024))) that the UK should look for authority over the conduct of boards in fulfilling their custodian duty to stakeholders as well as their agency role to shareholders. Their role is to ensure that companies have the culture, values, strategies, processes and procedures in place to profit without harm and the systems for accounting, auditing and reporting to record that is the case. Courts then adjudicate on private and public litigation cases having regard to the adequacy of a company's governance arrangements.

Measurement and Reporting

In undertaking this function, measurement of performance in relation to a company's purpose is critically important and international standard setters are establishing the criteria by which companies will be expected to report on their performance in meeting environmental and social considerations.

There are two sets of proposals on reporting that are in the process of being implemented. The first are proposals from the Securities and Exchange Commission (SEC (2024)) in the USA, and the International Sustainability Standards Board (ISSB (2023)) on disclosures regarding sustainability related financial risks, particularly climate related financial risks, e.g. the risks associated with fossil fuels. To many people, the need for such disclosures seems indisputable, but not to everyone. Some people and organizations believe that fossil fuels still have decades of useful commercial life left (see, for example, Thomson Reuters (2021)).

The ISSB intends to go beyond climate in extending financial disclosures to other risks, especially those relating to nature and society. However, the further one moves along this spectrum the more controversial and difficult the risks become to measure. More significantly, they only relate to the financial risks of shareholders and not to the financial and non-financial risks borne by those impacted by them – employees, customers, suppliers, communities and the natural world. They are, in the technical terminology, "financial or single materiality".

The problem with the ISSB approach is that it does not address the impact of companies on the environment and society, but the impact of the environment and society on companies. It does not measure the costs of avoiding detriments or cleaning up the mess that companies create. It measures financial risks that the environment and society impose on companies. It is not therefore seeking to determine the true costs of avoiding the detriments that companies impose on the environment and society, and therefore their fair and just profits

The second approach attempts to address this. It is associated with the EU's Corporate Sustainability Reporting Directive (CSRD) (European Union (2022)), the Corporate Sustainability Due Diligence Directive (CSDDD) (European Union (2024)), and the Sustainable Finance Disclosure Regulation (SFDR) (European Union (2019)). This regulatory approach requires reporting on environmental and social risks, for example human rights, from the point of view of those affected by as well as investing in firms. It measures the impact that companies have on others, not just the effect of environmental and social risks on investors and it is therefore an impact or double materiality form of ESG.

In particular, the CSDDD requires companies not only to report on the impacts they have on others but to incur the costs of avoiding detriments in their supply chains. And the SFDR requires investment funds to declare whether they are Article 8 funds that invest in companies with environmental and social characteristics or Article 9, essentially impact, funds that invest in companies with specific environmental and social benefit and detriment avoidance objectives.

But there are three problems associated with these international initiatives. First, many if not most problems that firms create cannot be standardized. They are not generic to all companies, countries and sectors. They are specific to the activities of firms, their locations, products, suppliers, and technologies. Second, the international reporting initiatives are focused on the detriments and problems companies cause, and, in the process, they increase the costs and undermine the competitiveness of firms. So, they are opposed by firms, people and politicians in developed and developing countries who worry about the consequences for jobs and growth.

Third, the approach that is being taken is too complex. Few people really understand what is being proposed. References to single/ double materiality, and financial/ impact ESG are largely impenetrable, even to experts in the field, and consequentially the initiatives are not gaining the universal traction they require. We need something much more straightforward and effective that everyone can grasp and understand as being of fundamental importance and practical significance.

Corporate Purpose

Profiting from solving problems not creating problems for others is simple and understandable. Everyone can grasp the notion that companies should not be profiting at the expense of others. They do not have a right to profit at our expense. They have a responsibility to ensure that they do not by incurring their true costs. Then and only then do they have the right to profit as they wish.

Their true costs are established partly by rules and standards set by national governments and international standard setters but largely by companies' own determination of the detriments they are causing. We need companies to adopt purposes of profitably solving not creating problems for others and to determine the metrics of whether they are doing that. We should expect companies to incur the costs of rectifying the problems where they are not, and to account for this in the most basic form of cost accounting. Not profiting from producing problems is simply an extension of traditional capital maintenance to those on whom a company impacts, for example on the natural world.

Above all we want it to be profitable for companies to solve problems. This provides precision, simplicity and clarity to the purpose of business, their strategic objectives, and their measures of performance and profits. It requires investing in capital enhancement to solve the problems that companies prioritize, and it creates a natural partnership between business, public and not-for-profit organizations seeking to enhance social and environmental wellbeing. Together they can credibly commit to a common purpose of shared prosperity.

Implications for ESG

The first point that the above analysis clarifies is the distinction between ESG in terms of the single materiality effect of environment and society on companies and the double impact of companies on the environment and society. While the former is of course relevant to the determination of firms' costs of capital and the valuation of corporate equity, it is not the basis for the determination of a company's true costs and just profits. For that, the double materiality approach is required (Mayer (2024a)).

Second, in determining the impact of the company on the environment and society, there are some components that will be determined at a national and international level by governments, regulators and standard setters. But there are many that will not be, and are specific to a company's particular purpose, processes and products. For these, a company should determine the impact that it has having on others – customers, employees, suppliers, communities, the environment and nature.

Third, the relevance of ESG is not just in terms of reporting and assessment of risks to investors or indeed to other stakeholders, but in determining the costs that companies should incur in avoiding the harms that they inflict on others, remedying them and meeting their positive problem-solving purposes. In other words, the objective is not just a reporting one but a determination of the true costs of a business and therefore a just and fair profit. This must drive a company's profit and loss statement, and be the subject of accounting, auditing and reporting processes, if it is really going to affect the behaviour of firms and internalize their negative externalities.

Fourth, there is an important distinction between positive and negative externalities, as noted by Adam Smith. Companies can and should do something to address the detriments they cause and incur the required expenditures. On the other hand, they cannot automatically earn revenues from the positive externalities they confer on others. It may be possible to internalize some of them through innovative business models, for example, the revenue generating mechanisms that internet companies employ, but many will require companies to partner with other organizations in the public and not-for-profit as well as the profit-making private sector if they are to be commercially viable.

Fifth, by preventing profiting from harm, companies only earn profits by solving problems. This therefore aligns the private interests of companies in profits with those of the public and not-for-profit sectors in enhancing social and environmental wellbeing. It therefore creates a natural cooperation between the private, public and not-for-profit sectors, where at present there is conflict from companies profiting by causing as well as solving problems.

Sixth, a purpose of profitably solving not creating problems eliminates the current polarization between concerns about the inadequacy of regulation in deterring detriments and the need for more stringent enforcement, and, on the other hand, the effects of regulation on freedom, jobs, growth and investment. Instead, companies are left to choose whatever purpose they think right, including maximizing profits, provided their profits are not earned at the expense of others.

Seventh, companies will be expected to report the positive human, social and environmental contributions they commit to making, how they will be measured and evaluated, the capital and other expenditures they will incur in delivering those benefits, and the projected revenues, profits and value creation associated with them.

Eighth, companies will report on their performance in meeting their past commitments, and how they will remedy and correct failures to do that, the associated costs and revised projected revenues, profits and value creation.

Ninth, companies will report on the detriments they have and might cause in the future, how they will avoid, mitigate, remedy and rectify them, the costs involved in doing that now and in the future, the potential revenues that might result and the effect on their profitability and value creation.

Tenth, asset management firms will evaluate the purposes of the companies in which they are investing, scrutinize the projected benefits and detriments they will deliver and cause, and the financial projections and risks associated with them. They will establish how they are fulfilling their purposes of profiting from investing in companies that are solving not creating problems and the implications of this for portfolio allocation and corporate engagement.

Conclusion

The definition of success should reflect the immense contribution that the private nature of the corporation has made to the explosion of prosperity, growth and poverty alleviation over the past 200 years. However, it should also recognize the contribution of companies to the wider human, social and natural system in which they operate. Addressing that is not achieved by simply imposing specific regulatory rules and taxation but by using corporate governance and corporate law to align the intrinsic nature of profit with the interests of all those on whom the firm impacts.

The minimum restriction that is required is "to profit without harm". ESG can assist companies and institutional investors with identifying where they are complying or failing in meeting that minimum restriction and delivering financial value from solving not creating problems. Ultimately, however, it must be reflected in corporate law and corporate governance rules that are overseen and enforced by audit, reporting and governance regulators and courts of law.

The reason why the ESG agenda is stalling is not just a problem of the quality of the information, its consistency and verification, but a lack of clarity about its objective. In the context of the purpose and success of corporations in company law, the role of ESG is clarified as being to align the interests of companies with ours as individuals, societies and the natural world by demonstrating that the profit of companies derives from solving not causing our problems.

There are three criteria by which the proposed resolution in this article should be evaluated. First, has it identified the correct underlying cause – namely a failure to align the fuel that powers the capitalist engine, namely profit, with solving not creating human, social, and environmental problems?

Second, is the proposed solution, namely, to require companies to incur their true costs of avoiding profiting from creating problems, correct? Third, is the proposed solution of incorporating profit without harm in the legal and governance definition of the success of the corporation practical and effective?

If the answers to these three questions are in the affirmative then the role and contribution of ESG to this more general agenda are clarified, simplified and extended. They demonstrate the need for ESG not only to be harmonized in international standards but also incorporated in individual firm accounting, auditing and reporting requirements. Together these lay the basis on which corporate governance codes and laws can ensure that companies succeed through advancement and progress, not advantage and regress.

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